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Clean Bill of Lading in Contract of Carriage and Documentary Credit: When Clean May not be Clean

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**CLEAN BILL OF LADING IN CONTRACT
OF CARRIAGE AND DOCUMENTARY
CREDIT: WHEN CLEAN MAY NOT BE
CLEAN**

*Časlav Pejović**

INTRODUCTION

X is a small producer of plastic products from China. Searching on internet for suppliers of plastic raw materials X found Y, a supplier based in the United States, offering these materials at a very favourable price. X and Y entered into sale contract under Cost, Insurance, and Freight (CIF) terms. Following CIF terms, payment was to be made by letter of credit. Y shipped the goods in a container and delivered for carriage within the agreed time. Carrier then inserted a “said to contain” clause into the bill of lading, and the bank accepted such document. When X opened container it discovered that the goods were in such bad condition that they could not be used in the manufacturing process. X contacted Y, by email, and demanded delivery of substitute goods, which would conform to the contract. Y refused, claiming that the goods were delivered for carriage in good condition. Y could not be reached by telephone, and its address stated on its website was wrong. X had no redress against the Carrier, because the Carrier validly excluded its liability with a “said to contain” clause. The Bank was also not liable, because this clause was acceptable under the letter of credit rules. X contacted a lawyer in the United States, and after receiving an estimate of attorney expenses, which would not be recoverable under the U.S. law, X decided to give up the case and bear the loss.¹

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It is common knowledge, in international trade community, that bills of lading (bills), under certain conditions, may contain reservations inserted by the master, and that banks normally should reject bills that are not clean. Yet, it is far less known that clean bills of lading, under the rules governing carriage of goods and those governing letters of credit may be not only different, but even contradictory. Specifically, certain clauses may make a bill of lading unclean under rules of carriage, but not under the letter of credit rules. It is interesting to note that all leading texts on letters of credit are silent on this issue.² One of the few scholars who has identified this issue is Hugo Tibergh, one of the world's leading maritime law authorities. Tibergh suggested that the Uniform Customs and Practices for Documentary Credits (UCP)³ should expand the meaning of "uncleanliness."⁴

Ph.D., Zagreb University. The author is grateful to Hugo Tibergh, Jan Ramberg, and Ravi Meckvichai for their constructive comments and suggestions, which helped to refine this article. I owe special thanks to David Meynell, Senior Technical Adviser to the ICC Banking Commission who provided valuable information regarding background of relevant provisions of the UCP. Of course, I remain responsible for all eventual errors in this paper.

¹ This is not hypothetical but a real case brought to my attention by my ex-student whose family was subjected to this kind of trouble.

² Ebenezer Adodo in his recent book on letters of credit, in an attempt to justify omission of a detailed discussion of transport documents in his text states that transport documents have not been "the subject of serious controversies in the last several decades", and that the banks are not "in great need of fresh insights" regarding this theme: EBENEZER ADODO, *LETTERS OF CREDIT: THE LAW AND PRACTICE OF COMPLIANCE* 7.02 (2014).

³ The Uniform Customs and Practice for Documentary Credits were promulgated by the International Chamber of Commerce (I.C.C.) in 1933, and were revised in 1951, 1962, 1974, 1983, 1993, and 2007 (I.C.C. Pub. No. 600). For most current version, see Int'l Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits*, I.C.C. Pub. No. 600 (2007) [hereinafter UCP].

⁴ Hugo Tibergh, *Carrier's Liability for Misstatements in Bills of Lading*, in *MARITIME FRAUD* 71 (1983). I have also written one paper on this issue, but from a different angle, with the main focus on the cause of the discrepancy of rules and different legal effects of clauses under two different sets of rules. Časlav Pejović, *Clean Bill of Lading in Contract of Carriage and Contract of Sale: Same Name and Different Meanings*, 2 J. INT'L COM. L. (2003).

The main objective of this article is to analyze the discrepancies between the rules governing carriage of goods by sea and the rules governing letters of credit, as well as highlight the potential problems that may arise as a consequence of this discrepancy, particularly in light of the risk of documentary fraud. The ultimate goal of this article is to draw attention to the need to revise the definition of a clean bill of lading in future UCP revisions.

I. BACKGROUND

The two most basic obligations in contracts of sale are (1) the obligation of the seller to deliver the goods and (2) the obligation of the buyer to pay the price. In international sales, the performance of both of these obligations is met with certain difficulties, mainly because of the distance between the parties. International sales involve a number of parties that are often geographically distant from each other; the seller's obligation of delivery is performed through a carrier under a contract of carriage, while the buyer's obligation of payment is normally performed through a bank, typically by letter of credit. The payment is regularly conditioned on evidence of the movement of the goods, i.e. by evidence that the goods are loaded onboard and are on their way to the destination.

An essential characteristic of overseas sales is that the buyer pays not against the delivery of the goods, but against the tender of a set of documents usually comprised of an invoice, a bill of lading, and a marine insurance policy. This implies that the seller has an obligation to make two kinds of delivery: (1) delivery of the goods and (2) delivery of the documents.⁵ Because the documents appear to be the subject matter of the sale, this sale is sometimes referred to as a "sale of documents."⁶ Once in possession of documents required by the

⁵ Article 30 of the Convention on Contracts for the International Sale of Goods (CISG) provides for this double obligation: "The Seller must deliver the goods, hand over any documents relating to them" United Nations Convention on Contracts for the International Sale of Goods, Apr. 10, 1980, 1489 U.N.T.S. 3, 19 I.L.M. 671, art. 30 [hereinafter CISG].

⁶ In *Arnhold Karberg & Co. v. Blythe Green Jourdain & Co.* [1915], 2 K.B. 379 at 388 (Eng.), Scrutton J referred to a CIF (cost, insurance, and freight) contract as a sale of 'documents relating to goods' but this was disapproved on appeal *Arnhold Karberg & Co. v. Blythe Green Jourdain & Co.* [1916], 1 K.B. 495 at 510, 514 (Eng.).

contract of sale, the seller notifies the buyer that he will tender those documents against payment or acceptance. The seller then presents the bill of exchange to the buyer's bank, together with a bill of lading and other documents. The bank should pay against the documents only if those documents are in accordance with requirements set by the UCP and the specific instructions of the buyer.

This specific character of a documentary sale is based on the bill of lading. When the parties agree that payment is to be made against documents, the seller must transfer to the buyer the bill of lading at the moment the buyer pays the price. By transferring the bill of lading to the buyer, the seller furnishes proof that he exercised his obligations under the sale contract and transfers to the buyer the right to receive the goods when they arrive at the port of destination. In this way, the seller can receive the price while the goods are still in transit and is assured that the title to the goods cannot pass to the buyer before he pays the price, while the buyer is assured that the goods will be delivered to him after he pays the price. One of the factors that contribute to the reliability of bills of lading is that the carrier warrants the accuracy of statements regarding the goods and is liable to their third party lawful holders in case of their inaccuracy. A buyer cannot inspect the goods while they are at sea, so he has to rely on the statements in the bill of lading. These statements provide evidence that the seller has properly performed his obligations by loading on time the conforming goods.⁷

II. CLEAN BILL OF LADING IN CONTRACT OF CARRIAGE

After the goods are delivered to the carrier, and upon demand of the shipper, the carrier must issue a bill of lading. Under Article 3(3) of the Hague-Visby Rules, bills of lading must show the leading marks, quantity, weight, or number of packages or pieces, and the apparent condition of the goods, furnished in writing by the shipper.⁸ Similar

⁷ Under clause CIF A8 of the Incoterms 2010, the seller has a duty to provide the buyer with a "usual transport document." This is usually understood to mean a clean on board bill of lading providing for the carriage of goods under deck, and for carriage to be performed without unreasonable deviation. INT'L CHAMBER OF COMMERCE, INCOTERMS 2010 cl. CIF A8 (2010), .

⁸ International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Aug. 25, 1924, 120 L.N.T.S. 155 (entered into force June

provisions are found in the Hamburg Rules⁹ and the Rotterdam Rules.¹⁰

The carrier can, under certain conditions, insert reservations in the bill of lading, which can drastically lessen its evidential value. Reservations are remarks inserted in a bill of lading by the carrier, his master, or his agent, which indicate the carrier does not guarantee the accuracy of particulars concerning the marks, nature, or quantity of the goods contained in the bill of lading, or that there are defects noticed in the condition of the goods or its packing for which the carrier is not responsible.

Under Article 3(3) of the Hague-Visby Rules:

no carrier, captain or agent of the carrier shall be bound to state or show in the bill of lading any marks, number, quantity, or weight which he has reasonable ground for suspecting not accurately to represent the goods actually received, or which he has had no reasonable means of checking.

The literal meaning of this provision refers to something which its drafters probably never intended. It is difficult to imagine that they meant that the carrier can issue a bill of lading without particulars concerning the “marks, number, quantity or weight,” since those particulars are essential for the existence of a bill of lading.¹¹ Under

2, 1931) [hereinafter Hague Rules], as amended by Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Feb. 23, 1968, 1412 U.N.T.S. 128 [hereinafter Hague-Visby Rules]. For the matter of simplicity, I will use the Hague-Visby Rules and will not refer to the Hague Rules, which are still applied in a number of jurisdictions.

⁹ United Nations Convention on the Carriage of Goods by Sea, Mar. 31, 1978, 1695 U.N.T.S. 3, 17 I.L.M. 608 (entered into force Nov. 1, 1992) [hereinafter Hamburg Rules].

¹⁰ United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea, G.A. Res. 63/122, U.N. Doc A/RES/63/122 (Feb. 2, 2009) [hereinafter Rotterdam Rules]. Rotterdam Rules are not yet in force.

¹¹ It should be noted that the original text of the Hague Rules (1921) adopted by the International Law Association (ILA) was somewhat different. It provided that, “no carrier, master or agent of the carrier shall be bound to issue a bill of lading showing description, marks, number, quality, or weight which he has reasonable

this literal interpretation, problems may have arisen with Article 3(3) of The Hague-Visby Rules. Instead, remedying this error, the content of Article 3(3) has been interpreted to imply that the carrier, in fact, should insert particulars concerning the goods as furnished by the shipper. Additionally, the carrier is entitled to qualify those particulars by inserting in the bill of lading reservations under conditions specified in this article.

The Hamburg Rules and the Rotterdam Rules expressly provide that the carrier has a duty to insert a reservations in the bill of lading under conditions that are essentially the same as in the Hague-Visby Rules.¹² Reservations are aimed at protecting the carrier from liability for inaccurate or false particulars furnished by the shipper. The justifications for these reservations are that the carrier cannot be asked to take responsibility for the accuracy of particulars that he cannot check and the necessity to protect the good faith of third party bill of lading holders. The reservations are not aimed at relieving the carrier from liability, but only at excluding the presumption that the goods are received for carriage by the carrier as described in the bill of lading.

In practice, it is often disputed whether loss of, or damage to, the goods occurred during the voyage, or whether it existed before the goods were delivered for carriage. One of the crucial problems for the buyer is to establish who is responsible for damage: the carrier or the seller. Here the bill of lading may play a key role as evidence. If the bill of lading contains remarks stating that the cargo was loaded in poor condition, this may provide evidence of the seller's liability for delivery of non-conforming goods. On the other hand, if the bill of lading contains no such remarks, this may evidence the carrier's liability.

If the carrier signs a bill of lading presented by a shipper without controlling the accuracy of the particulars furnished by him, he risks liability to a third party holder of the bill of lading if those particulars are inaccurate. This is why the carrier should be very careful

ground for suspecting do not accurately represent the goods actually received." It is one thing that the carrier is not bound to issue a bill of lading, and a different one that the carrier issues the bill of lading but is not bound to state in the bill of lading the particulars concerning the goods (on file with author).

¹² Hamburg Rules, *supra* note 9, art. 16(1); Rotterdam Rules, *supra* note 10, art. 40(1).

when receiving the goods from the shipper and should check the accuracy of the description of the goods as furnished by the shipper, as well as the apparent condition of the goods. However, sometimes it is impossible to perform such checks, e.g., if the goods are delivered for carriage shortly before the ship's departure or if the goods are in sealed containers so that the number of packages and condition cannot be verified. In such cases the carrier is entitled to insert reservations into the bill of lading.

There are two types of reservations: (1) reservations which refer to the particulars furnished by the shipper concerning the general nature, marks, number, and weight of the goods and (2) reservations concerning the condition of the goods. The legal effect of these two types of reservations is different.

A. Reservations Referring to the Nature, Marks, Number, and Weight of the Goods

Reservations referring to the particulars furnished by the shipper deprive those particulars of their evidential value. It is assumed that the carrier delivered the goods to the consignee as he received them from the shipper. Such a bill of lading is not even *prima facie* evidence of the particulars to which the reservation refers. Those particulars are deprived of every evidentiary effect, and are considered to be only a declaration made by the shipper, without the carrier's liability for their accuracy. The carrier is only liable on the basis of the receipt of the goods (*ex recepto*), which means that he must deliver the goods to the consignee as he received them from the shipper. As a result, a third party holder of the bill of lading is entitled to the goods not as they are described in the bill of lading, but as they were delivered for carriage by the shipper.

Reservations limit, but do not eliminate, the evidentiary effect of the bill of lading. Only the particulars to which the reservations refer lose their evidentiary value, while other particulars retain their evidentiary effect. For instance, a reservation referring to weight has

no influence on the evidentiary effect of the number of pieces stated in the bill of lading.¹³

Reservations do not exempt the carrier from his responsibility, but only switch the burden of proof (*onus probandi*) from the carrier to the consignee. If the carrier fails to insert notations, he would be precluded from proving against third party holders of the bill of lading that the particulars in the bill of lading were inaccurate and would bear the burden to prove that he is not liable for loss or damage. In that case the consignee would not be bound to prove the carrier's liability, but the carrier has the burden to prove that he is not liable for loss or damage. A reservation switches the burden of proof to the consignee, who must prove that the particulars in the bill of lading were correct and that the carrier is liable for loss or damage.

The effect of reservations is that they make such proof more difficult. If the bill of lading does not contain reservations, the consignee would only have to prove that the goods he received from the carrier do not correspond with the bill of lading description leaving to the carrier to avail himself of any defenses to avoid liability. If the bill of lading does contain reservations, then the consignee cannot rely on the bill of lading as proof but must offer other evidence of carrier's liability for damage.

B. Reservations Referring to the Condition of the Goods

The bill of lading should show only the apparent condition of the goods, which means the external condition of the goods "so far as meets the eye."¹⁴ Even if a bill of lading does not contain this clause, the goods will be considered as delivered for carriage in apparent good condition, unless the master has inserted remarks in the bill of lading stating the goods defects.

Reservations referring to the condition of the goods are based on the carrier's observation and represent, in fact, his statement of any defects in the goods noticed during the inspection of the goods at the port of loading. These reservations are *prima facie* evidence that the

¹³ Attorney General of Ceylon v. Scindia Steam Navigation Co., India [1962] A.C. 60 (Eng.).

¹⁴ The Peter der Grosse [1875] 1 P.D. 414 (Eng.).

goods were loaded in the condition as described in the reservations. Therefore, they place the burden of proof on the consignee, who needs to prove that the goods were loaded in good condition, and that the damage occurred during the voyage.

If the carrier fails to insert reservations concerning the condition of the goods and the goods are found to be damaged when delivered to the consignee, the carrier will be held responsible for damage unless he proves that the damage was caused by one of the circumstances for which he is not responsible. Where the goods are loaded in poor condition, it is still possible to avoid clausing a bill of lading. If the shipper's description of the goods in the bill of lading provides a complete and accurate description of the cargo, there would be no need for any clausing of the bills of lading by the master. The goods that are properly described as damaged can be considered as "in good condition" in the sense of being in "proper" order and condition.¹⁵ The cargo that is properly described as damaged or imperfect in some way can be stated to be in "good order and condition" in the sense of being in "proper" order and condition. Thus a cargo described in a bill of lading as "scrap" or as "hot rolled steel coils with pitting and gouging" can be stated to be in "good order and condition."¹⁶ If the description of the goods is such that the master can sign a bill of lading that says that those goods, as described, are in "apparent good order and condition," then the cargo will not be "subject to clausing of the bill of lading." But if the master would have to make a notation on the bill of lading so as to reconcile the description of the goods with a statement that they are in "apparent good order and condition," then the cargo is "subject to clausing of the bill of lading."¹⁷

The fact that the bill of lading does not state that the goods loaded are in bad condition does not exclude the possibility that there are defects in loaded goods.¹⁸ If the carrier proves that the damage to the goods was of such a character that it was impossible to discover it

¹⁵ Sea Success Maritime Inc. v. African Maritime Carriers Ltd. [2005] EWHC (Comm) 1542 (Eng.).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ Tokio Marine Fire & Ins. Co. v. Retla S.S. Co., 426 F.2d 1372 (9th Cir. 1970).

by an ordinary examination of their external condition, the cargo claimant would not only have to prove that the goods were not damaged when delivered for carriage, but also provide such proof as may be needed to impose carriage liability, e.g., that the ship was not seaworthy. However, if the consignee proves that the carrier knew, or should have known, that the goods were damaged when he received them for carriage, the carrier will be responsible if he failed to insert the reservation in the bill of lading stating that damage.¹⁹

IV. CLEAN BILLS OF LADING IN LETTERS OF CREDIT

In a documentary sale, the bill of lading serves as evidence of whether the goods are loaded, when they are loaded, and which goods are loaded. Based on the bill of lading, it can be established whether the goods were delivered for carriage and loaded on time, as stipulated by the contract of sale, as well as whether the goods delivered for carriage correspond with the goods agreed by the contract of sale. To perform its role in a documentary sale, the bill of lading must provide certainty to its holder with respect to the accuracy of the particulars contained in it, and the carrier must be precluded from denying the accuracy of those particulars.

The letter of credit rules provide specific requirements related to reservations. As a matter of principle, the bill of lading should be free of all notations with respect to the apparent condition of the goods and packaging. Under Article 27 of the UCP, a clean bill of lading is defined as “one that bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging.” Banks must refuse bills of lading that contain such clauses or notations, unless the letter of credit expressly stipulates the clauses or notations that may be accepted. The buyer can give instructions to its bank with respect to the requirements of the documents; if there are no such instructions, the requirements contained in the UCP rules will apply.

¹⁹ The *Nogar Marin* [1988] 1 Lloyd’s Rep. 412 (Eng.); *Dent v. Glen Line* [1940] 67 Lloyd’s Rep. 72 (Eng.); Cour d’appel [CA] [regional court of appeal] Rouen, Oct. 10, 1991, D.M.F. 1993, 108 (Fr); Cour d’appel [CA] [regional court of appeal] Paris, Apr. 17, 1995, D.M.F. 1985, 173 (Fr.).

V. DISCREPANCIES AND CONFUSION

When the meaning of clean bill of lading under the rules applying to carriage of goods and to letters of credit is compared, discrepancies become obvious. All international conventions governing carriage of goods by sea provide that reservations regarding leading marks, quantity, the general nature of the goods, and their condition make a bill of lading unclean.²⁰ The UCP limits the definition of a clean bill of lading to notations declaring defective condition of the goods and/or packages. This definition is in line with some well-known cases.²¹ On the other hand, it deviates from other cases that gave effect to notations related to quantity, making such bills unclean under the rules governing carriage by sea.²² There are also other discrepancies, e.g., regarding the effect of “said to contain” clauses.

At a more general level, the confusion about the meaning of a clean bill of lading is caused by the fact that the parties in a contract of carriage are usually also the parties in the contract of sale (the shipper is often the seller, while the consignee is often the buyer), and because the subject matter of these contracts is the same (the carried goods are identical with the sold goods). However, even though the same parties and goods appear in both the contract of carriage and the contract of sale, these two contracts are regulated by different rules. The rules regulating the contract of carriage are aimed at defining the duties and rights of the carrier and the shipper and/or consignee, while the rules regulating the contract of sale are aimed at specifying the duties and rights of the seller and the buyer.

The rules regulating the liability of the carrier are limited in scope to the contract of carriage and are not concerned with the contract of sale. If the carrier issues a clean bill of lading, it does not mean that the goods are in conformity with the goods under the

²⁰ Hague-Visby Rules, *supra* note 8, art. 3(3), Hamburg Rules, *supra* note 9, art. 16(1); Rotterdam Rules, *supra* note 10, art. 40(1) referring to art. 36(1).

²¹ *British Imex Indus. Ltd. v Midland Bank Ltd.* (1958) 1 Q.B. 542 (Eng.); *Golodetz & Co. v Czarnikow* (1980) 1 W.L.R 495 (Eng.).

²² *New Chinese Antimony Co. Ltd. v. Ocean S.S. Co.* [1917] 2 K.B. 664 (Eng.), *Attorney General of Ceylon v. Scindia Steam Navigation Co., India* [1962] A.C. 60 (Eng.); *The Mata K* [1998] 2 Lloyd's Rep. 614 (Eng.).

contract of sale. The carrier is not entrusted with checking whether the goods comply with sale contract, but only with their carriage; he is responsible only if the goods do not correspond with their description in the bill of lading. The rationale of the carrier for inserting reservations is the protection of his own interests as a party in the contract of carriage. From the carrier's perspective, the fact that he inserted reservations in a bill of lading, or that he failed to do so, is relevant only for his relation with the bill of lading holder. However, that fact can be very important for the relation of the parties in the contract of sale, as well as in letters of credit.

The bill of lading is a transport document issued under a contract of carriage and is not always suitable to serve as evidence in a contract of sale. The buyer cannot rely on the carrier and transport documents as sufficient grounds for establishing whether the goods were in conformity at the moment of loading because the carrier applies his own standards and rules based on rules governing carriage of goods, and not sale, when checking the goods.

The fact that the carrier has issued a clean bill of lading does not necessarily mean that the seller has delivered for carriage the goods as provided by the contract of sale, but only that the carrier acknowledged that the goods correspond with their description in the bill of lading and that they are in apparent good order and condition. For example, the seller might deliver for carriage the goods of a quality which does not correspond to one agreed by the contract of sale, but the carrier cannot be expected to state this discrepancy of quality in the bill of lading, since he is usually not an expert on the goods and is not liable for the quality of the goods.

VI. SPECIFIC PROBLEMS UNDER THE UCP

The UCP contains rather imprecise guidance regarding "clean bills of lading," which deviates from the rules on clean bills of lading in the law governing carriage of goods by sea. There are even some discrepancies with the rules governing international sales, while some of problems are confined to the UCP. The problems may arise in cases of all particulars on the goods, as will be shown below.

A. Quantity

A bill of lading containing a notation that states a shortage of the goods cannot be clean. This fact is clearly stated in all international conventions regulating carriage of goods by sea and is confirmed by numerous court decisions. In a clear contrast to the rules governing carriage by sea, the UCP definition of clean bill of lading is restricted to the condition of the goods and packages. For some unclear reason, the reservations regarding quantity are omitted from the definition of clean bill of lading. Hugo Tiberg proposed a wider meaning of unclean bill of lading to refer to a “document bearing an express notation of insufficiency concerning either the quantity or condition of the goods or their packaging.”²³ This proposal is the starting point for a more detailed elaboration on this issue below.

The failure to include reservations related to quantity in the definition of clean bill of lading raises the issue of whether this failure can be remedied by other provisions of the UCP. To certain extent, Article 30 of the UCP may play this role. This provision does not specifically make reference to transport documents, but it obviously applies to them, as well as to the invoice. Article 30(b) provides for tolerance of 5% for quantity “provided the credit does not state the quantity in terms of a stipulated number of packing units or individual items and the total amount of the drawings does not exceed the amount of the credit”. This means that reservations indicating shortages of less than 5% of quantity would be acceptable, but this tolerance is not applicable to the number of packing units or individual items when stated in the letter of credit.

The application of Article 30(b) depends on the type of merchandise shipped.²⁴ Article 30(b) would apply where the credit states, e.g., “1000kg of coffee.” In this case, the beneficiary could ship up to 5% less, i.e., between 950kg and 1000kg, or up to 5% more, i.e., between 1000kg and 1050kg (subject to credit amount not being

²³ See Tiberg, *supra* note 4, at 78.

²⁴ Example: letter of credit value is \$100,000.00 (USD); Goods shipped: 1000kg of coffee. In this case, the exporter is allowed to ship up to 1050kg (or 950 kg) of coffee but not allowed to draw more than \$100,000.00 (USD). This tolerance disappears in case of the number of packing units or individual items, e.g., if the bill of lading states that 1000 boxes containing bottles of wine are loaded.

exceeded). This means that banks should reject bills of lading when there is a discrepancy higher than 5% in the case of quantity, as well as in case of any discrepancy related to the number of packages. A problem may arise if a bill of lading indicates a shortage within the tolerance defined by Article 30(b), e.g., when it contains a clause stating: “10 tons missing” (if we assume that the total amount is 1000 tons, a shortage of ten tons is just 1% of the total amount). Should the bank accept such bill of lading? From the position of the buyer, a shortage of the quantity should be valid cause for rejecting documents. On the other hand, under the UCP, the bank will be required to accept such bill of lading, unless specifically instructed not to do so.

Article 30(b) creates a discrepancy in the rules applicable to letters of credit, as well as a number of ambiguities that may arise in various situations related to its application to bills of lading. For example, why should a bank accept a bill of lading containing a shortage of ten tons of cargo when the quantity stated in the bill of lading is 1000 tons, and why should it reject the bill of lading when one out of a hundred boxes is missing? What is the logic? Is one box containing twelve bottles of mineral water more valuable and important than ten tons of coffee? There should be some reason for this kind of drafting of the UCP, but if so, it is far from obvious.

A notation that refers to a minor defect may be acceptable to the buyer, but not to the bank, because such notation makes a bill of lading unclean under the UCP rules. On the other hand, a notation within the tolerance defined by Article 30(b) would be acceptable to the bank, but not necessarily to the buyer. Would the buyer agree to a every shortage that is less than 5%? There have been many cases where a buyer has sued the seller or carrier for far lower percentages of shortage. Article 30(b) may contradict the law governing contract of sale, for the law of each country sets out its own percentage of tolerance. The problem will arise particularly where the law governing contract of sale provides a lower tolerance. This means that Article 30(b) of the UCP may contravene both the rules applying to carriage of goods by sea and those applying to contract of sale. The real risk for the buyer is that this provision requires the bank to pay against bill of lading which contains express reservation regarding shortage of quantity, where the shortage is within the tolerance of 5%.

The report on clean bills of lading prepared by the International Chamber of Commerce (ICC) states that clauses relating to quantity “are in a different class, in that they merely reflect a difference of opinion between seller and carrier as to the exact quantity of good loaded on board.”²⁵ It is true that these clauses are in a different class, but not merely because they reflect a different opinion, because the clauses related to condition may also reflect a difference in opinion between seller and carrier. For example, there is often a discussion between the shippers and the master (or his agent) as to the proper description of the condition of the cargo.²⁶ In fact, shipper and carrier are more likely to have “a difference of opinion” regarding condition rather than regarding quantity; quantity can be more easily verified, when in dispute, while the assessment of apparent condition of the goods is often based on subjective impression.

The difference between these two types of clauses lies in their different legal effects: while clauses related to quantity deprive them of evidential legal effect, clauses related to condition create a presumption that the goods are loaded with defects as stated in the reservation. This difference does not justify omitting reservations related to quantity from the definition of clean bill of lading. It is obvious that a bill of lading with a notation stating shortage of quantity of goods cannot be a clean bill of lading, particularly from the perspective of the buyer’s interests. To avoid the risk, the buyer should specifically instruct its bank to reject clauses that refer to a shortage of the goods.

While banks normally have no problem with accounting, why should the banks bear a duty to calculate the percentage of shortage and then determine whether the shortage is within the tolerated amount? Would it not be more practical to simply adopt the same rule as in carriage of goods: any reservation regarding quantity should make the bill of lading unclean? The tolerance of shortage should not be prescribed as a standard in the UCP, but it should be an exception agreed upon by the parties to the contract of sale. If the parties agreed certain degree of tolerance, the buyer should arrange to have this condition in the letter of credit so as to override the default 5%

²⁵ INTERNATIONAL CHAMBER OF COMMERCE, *THE PROBLEM OF CLEAN BILLS OF LADING* 14 (1962).

²⁶ *Sea Success Mar. Inc. v. African Mar. Carriers Ltd.* [2005] EWHC (Comm) 1542 (Eng.).

tolerance. In such case the applicant should expressly instruct the bank in the letter of credit that specified tolerances may be allowed; if the instructions are silent on this, there should be no tolerance. As it is shown above, there are plenty of arguments speaking in favor of expanding the UCP definition of clean bill of lading so as to include notations regarding quantity.

B. “Said to Contain” Clauses

Another point of confusion relates to Article 26(b) of the UCP. According to this article, banks will accept bills of lading that contain clauses such as “shipper’s load and count,” “said by shipper to contain,” or words of similar effect.²⁷ In the context of the UCP, this provision can be justified by the fact that these clauses do not expressly declare a defective condition of the goods and, therefore, do not make bills of lading unclean under the UCP rules. The situation, however, can be different in contract of carriage.

In contracts of carriage clauses, “shipper’s load and count” or “said by shipper to contain” are often not given effect by the courts when they are pre-printed in bills of lading. In such cases, Article 31(ii) of the UCP would not cause problems. However, under certain conditions, these clauses can have effect under the rules governing carriage of goods and make a bill of lading unclean. Where the goods are carried in containers packed and sealed by the shipper, the carrier has no duty to open them to check the contents. In this case it is clear *in re ipsa* that the carrier cannot check the contents due to the conditions of carriage. This means that there is no need for the reservations to be specific and the carrier can insert reservations such as “said by shipper to contain” or simply “said to contain.” This kind of reservations has been upheld in a number of jurisdictions.²⁸

English courts give effect to general reservations relating to weight or quantity unknown.²⁹ If a bill of lading states that the weight

²⁷ See UCP, *supra* note 3, art. 26(b).

²⁸ Robert Wijffels, *Aspects juridiques du transport par conteneurs*, E.T.L. 337 (1967).

²⁹ *The Mata K* [1998] 2 Lloyd’s Rep. 614 (Eng.); *Noble Res. Ltd. v. Cavalier Shipping Corp.* [1996] 1 Lloyd’s Rep. 642 [hereinafter *The Atlas*] (Eng.); *The Esmeralda* [1988] 1 Lloyd’s Rep. 206 (Eng.).

of goods is unknown, the carrier can rely on it as evidence to contradict the weight recorded in the bill of lading.³⁰ In such case, no estoppel can be raised against the carrier, since he made no representation. In common law the main focus is on the fact of whether a representation is made, rather than whether the qualification is true.³¹ If the statement of the weight or quantity of goods in the bill of lading is qualified by such words as “weight or quantity unknown”, the bill of lading is not even prima facie evidence against the carrier of the weight or quantity shipped.³² Similarly, where goods are shipped in a container and the bill of lading is “said to contain” a given number of packages, so that it is plain that the carrier has no knowledge of the contents of the container, the carrier is not estopped from denying that the stated number of packages were in fact in the container. The onus is on the cargo-owner to prove what was in fact shipped.³³

Many other jurisdictions have taken a similar stance. In the United States, Section 7-301(b) of the Uniform Commercial Code (U.C.C.) recognizes the validity of clauses such as “contents, condition, and quality unknown,” and “said to contain,” in case of the goods “concealed in packages.”³⁴ German law provides for the possibility of inserting the reservation “contents unknown” (“Inhalt unbekannt”) if the goods are carried packaged or in containers.³⁵ Italian courts take a similar view “when it is reasonably impossible to establish if the carrier has no reasonable means of checking the information furnished by the

³⁰ *The Atlas*, 1 Lloyd’s Rep. at 646.

³¹ RICHARD AIKENS, RICHARD LORD & MICHAEL BOOLS, *BILLS OF LADING* 4.32 (2006).

³² *Conoco (UK) Ltd. v Limai Mar. Co.* [1988] 2 Lloyd’s Rep. 613 (Eng.) [hereinafter *The Sirina*].

³³ WILLIAM TETLEY, *MARINE CARGO CLAIMS* 351 (4th ed. 2008).

³⁴ *Transatlantic Marine Claims Agency v. M/V IBN Zuhr*, Civ. A. No. CV 493–292, 1994 WL 654548 (S.D. Ga. May 27, 1994); *Recumar Inc. v. S/S Dana Arabia*, 83 Civ. 6486 (BN) (JES), 1985 WL 479 (S.D.N.Y. Apr. 5, 1985); *Aetna Ins. Co. v. General Terminals*, 225 So.2d 72 (La. Ct. App. 4 1969); THOMAS SCHOENBAUM, *ADMIRALTY AND MARITIME LAW* § 10-22 (4th ed. 2004).

³⁵ *Oberlandesgericht [OLG] [Hamburg Regional Court] Oct. 2, 1969 VersR 1125*, 1970 (Ger.); *Oberlandesgericht [OLG] [Hamburg Regional Court] Nov. 30, 1972 VersR 344*, 1973 (Ger.); SEEHANDELSRECHT 511 (Prussman-Rabe eds., 5th ed. 2000); SCHAPS/ABRAHAM: SEERECHT 821 (Walter de Gruyter ed., 1964).

shipper.”³⁶ A similar position is taken by Belgian courts, which have held that the notation “said to contain” inserted in a bill of lading represents a valid qualification where the carrier is not able to check the condition of the goods.³⁷

Article 40(4) of the Rotterdam Rules contains specific provisions for situations in which goods are delivered for carriage to the carrier in a closed container. In such case the carrier may qualify the particulars on the goods if the goods inside the container have not actually been inspected by the carrier and the carrier did not have actual knowledge of its contents before issuing the transport document. With respect to the particulars on the weight of the goods, the carrier may qualify those particulars if he did not weigh the container, and the shipper and carrier had not agreed prior to the shipment that the container or vehicle would be weighed and the weight would be included in the contract particulars, or there was no physically practicable or commercially reasonable means of checking the weight of the container or vehicle. Another scenario is found in Article 40(1) of the Rotterdam Rules, which deals with situations in which goods are not delivered for carriage in a closed container, or when they are delivered in a closed container and the carrier actually inspects them. In this case the carrier may insert reservations in the transport document if he had no physically practicable or commercially reasonable means of checking the information furnished by the shipper, or he has reasonable grounds to believe the information furnished by the shipper to be inaccurate.³⁸

³⁶ Corte di Cassazione 29 November 1999, No. 13341, *Giur. it.* 2001, III, 729 (It.); Corte di Appello di Napoli, 21 June 1996, unreported, *Rocco Giuseppe & Figli S.p.A. v. D.I.A.R. Maritime S.r.l.* (It.).

³⁷ Hof Van Beroep [HvB] [Court of Appeal] Antwerpen May 27, 2013, *European Transport Law [E.T.L.]* 2013, 581 (Belg.).

³⁸ Article 40(1) of the Rotterdam Rules may create problems in practice. For example, there might be disagreement as to what extent the carrier who actually inspected the goods in a closed container was able to verify the information furnished by the shipper. It is also not very clear who would have the burden of proof in case of a dispute: would the carrier have the burden of proof that he was entitled to insert qualification in the transport document, or would it be on the claimant to prove that the qualification was not justified? The answer to these questions can be obtained only if the Rotterdam Rules enter into force, and it is very likely that those answers may not be the same in all jurisdictions. Rotterdam Rules, *supra* note 10, art. 40(1).

The previous examples from several leading maritime jurisdictions and the text of the Rotterdam Rules demonstrate a clear discrepancy between the UCP and the laws governing carriage of goods by sea. Namely, under the UCP, clauses such as “said to contain” do not have effect on the status of bills of lading, which remain clean and acceptable by banks. On the other hand, similar clauses may have an effect under carriage by sea rules, making bills unclear.

The UCP’s unreserved acceptance of “said to contain” type clauses can make the buyer a victim of fraud, if the seller as shipper furnishes the carrier with a false description of the goods loaded in a container (e.g., the bill of lading states that music records are loaded, while in fact some garbage is loaded), and the carrier inserts in the bill of lading the clause “said by shipper to contain.”³⁹ In such a case the bank will pay against such a document, the carrier will not be liable for wrong description of the goods, and the seller may ‘disappear’ or become insolvent. Bills of lading should provide security to the buyer, and that security may be compromised if the banks accept bills which would not be acceptable to the buyer. The UCP needs a revision of its text to avoid potential risks, confusion, and problems arising from the discrepancy of rules applicable to “said to contain” type clauses. One possible solution is simply to delete Article 26(b) and leave the parties to deal with these issues on a case-by-case basis.

Under the existing rules the buyers can still protect their interests and ensure that banks will not accept transport documents that are not acceptable to them. The buyers are advised to include in the letter of credit requirements obligating the beneficiary (seller) to produce the certificate of control where the goods are to be carried in container sealed by the shipper. Less experienced traders may not be familiar with these protective devices, as the illustration that opened this text has shown, but such problems may happen even to large companies.⁴⁰

³⁹ Discount Records Ltd. v Barclays Bank Ltd. [1975] 1 W.L.R. 315 (Eng.).

⁴⁰ Daewoo Int’l (America) Corp. v. Sea-Land Orient Ltd., 196 F.3d 481 (3d Cir. 1999).

C. Condition

Serious difficulties may also arise with respect to notations on the condition of goods. It is not always clear which notations make a bill of lading unclean in documentary sale. Even a notation that is acceptable to the buyer is likely to cause a bank to refuse the bill of lading due to the “strict compliance” rule.⁴¹ A clean bill of lading does not always mean that the condition, and especially the quality, of the goods is in conformity with the sale contract in much the same way as an unclean bill of lading does not always mean that the goods are not in conformity with what the seller and buyer have agreed. This is because the notations in a bill of lading are aimed at protecting the carrier from liability under the contract of carriage. The notations are inserted by the carrier, who is not expected to know whether the goods delivered for carriage are in conformity with the goods under sale contract. Therefore, those notations cannot be expected to offer a firm answer as to whether the goods correspond with the sold goods. A requirement for a clean bill of lading may serve the buyer as an excuse to refuse an unclean bill of lading, even when the reservation states a fact the seller and the buyer have agreed upon.

A notation inserted by the carrier does not necessarily make a bill of lading unclean as between the seller and the buyer, even if it expressly declares the defective condition of the goods or packaging. For example, a bill of lading with the notation “atmospheric rust spotted” relating to iron products should not be refused by the buyer, because in the case of sea carriage of iron products traces of atmospheric rust are usual and perhaps even inevitable.

Similar situations may arise in cases of description of packing. Buyers are, of course, mainly interested in goods rather than packing, which only serves to protect the goods. For example, the notation “used bags” would not necessarily make a bill of lading unclean, unless the buyer insists on new bags. Actually, it may well be that the buyer and the seller have agreed in a contract of sale on cheaper packing, which might not be very suitable for the goods but would enable the buyer to cut the price, e.g., cardboard boxes instead of wooden boxes. In such a case a notation inserted by the carrier in the bill of lading

⁴¹ *Golodetz & Co. v Czarnikow* (1980) 1 W.L.R 495 (Eng.).

stating insufficient packing will not give the buyer the right to refuse the bill of lading because the buyer agreed to such packing in the contract of sale.

As far as the carrier is concerned, he is usually not interested in the transaction between the seller and buyer, but only in the proper performance of the duties he has under the contract of carriage. If he noticed upon receipt of the goods that the packing was insufficient and has stated this in the bill of lading, he will be protected in case of loss or damage caused by such packing. Needless to say, such notation will require the bank to refuse documents, unless specifically authorized to accept them.

On the other hand, the buyer should also be aware that the carrier's duty of control over the condition of the goods is limited to the apparent condition, so that a clean bill of lading does not have to mean that the goods are actually in good condition.

The present UCP definition of clean bill of lading does not require change in the part regarding condition of the goods, but certain caution may be necessary in relying on such definition. Depending on the kind of goods, the buyer might need the services of a surveyor at the port of shipment to determine whether the goods correspond with the requirements of the contract of sale.

D. Marks and General Nature of the Goods

Reservations related to marks should be stamped in such a manner that they are clear and legible not only at the moment of loading, but also at the time of delivery to the consignee. Marks can be very important for the buyer, and when the goods are properly marked they can be identified at the destination. On the other hand, improper leading marks may expose the buyer to serious risk and difficulties. It is not clear why the UCP failed to include reservations regarding deficiency of marks in the definition of clean bill of lading. Maybe those reservations are not often used, and practical importance is lower than in the case of remarks concerning condition. But, as a matter of principle, the UCP should have at least made a reference to those reservations. The same applies to the nature of the goods, although it may be assumed that reservations regarding the nature of the goods are very seldom used.

CONCLUSION

The fact that a clean bill of lading has two different and sometimes contradictory meanings has not been adequately addressed so far in the literature on letters of credit. Problems related to discrepancy of rules may exist in cases of all particulars on goods inserted in bills of lading. Such discrepancies can cause serious difficulties to all parties involved. It is rather cumbersome and can be confusing to assess the legal effect of the same document by applying different and even conflicting rules and standards when there is no obvious reason for that. This is a flaw in the system that could be rectified by clearer rules.

The UCP rules on clean bills of lading are not sufficiently clear, which may expose buyers to serious risks. The main controversies exist in cases of reservations related to quantity and “said to contain” type clauses.

Serious problems may arise in case of reservations regarding the quantity of the goods, since the UCP lacks clear guidance in such situations. There is also a clear departure from the rules on clean bills that apply to contract of carriage, which is particularly confusing and difficult to explain. Reservations stating shortage of the quantity are usually not acceptable for the buyers, and it is difficult to understand why the UCP ignored this. Buyers should be aware of the risk that banks would pay against a bill of lading containing a reservation related to quantity where the shortage is within the tolerance of 5% as provided by Article 30(b). This provision, however, has a different objective and may not be suitable for applying to the reservations regarding quantity, which may create additional confusion and problems to buyers. To avoid this risk, buyers should expressly instruct banks not to pay against a bill of lading containing reservations regarding the quantity.

Another problem that may arise is related to different standards regarding the legal effects of “said to contain” type clauses. This clause may make a bill of lading unclean under the contract of carriage, but will never do so under the UCP, thus exposing buyers to a potentially great risk. Drafters of the next UCP may consider deleting Article 26(b), which contravenes the carriage rules and may even

facilitate the fraud. To avoid the risk imposed by “said to contain” type of clauses, the buyer should arrange for inspection of the goods before their delivery to the carrier and demand the seller to produce the certificate of inspection. Relating to documentary fraud, the principle of autonomy applying to letters of credit, and the fact that banks are bound to examine merely whether the documents comply with the terms of the credit makes it easier for dishonest sellers to commit fraud. Part of the problem is that the UCP often rely on trust instead on verification. Things are made even worse by some court decisions, which restricted the fraud exception to fraud by the beneficiary, making third party fraud outside the scope of the fraud exception.⁴²

The shortcomings in the present text of the UCP are obvious. For an outsider, it is difficult to understand why the ICC failed to rectify them in numerous revisions of the UCP. One possible explanation is that banks are not prepared to take additional burdens in examining transport documents. Another possible reason is that letters of credit function relatively well and not many problems actually arise in practice. However, the risk of fraud should not be underestimated, as even large companies may be defrauded under the existing system.⁴³ Manoeuvring through the murky waters of fraud infected letters of credit can be very risky and cumbersome. Revisions of the relevant UCP provisions may substantially reduce the potential for fraud. Prevention is better than cure.

⁴² United City Merchs. (Inv.) Ltd. v. Royal Bank of Can. [1983] 1 A.C. 168 (Eng.).

⁴³ See, e.g., Discount Records Ltd. [1975] 1 W.L.R. 315; see also Daewoo Int'l., 196 F.3d 481. Recently (June 2015) I received information about similar problems facing one of the largest companies in Thailand. This company bought steel scrap from an U.S. company. The goods were shipped in containers sealed by the shipper. Carrier inserted “said to contain” clause in the bill of lading, the bank has made payments pursuant to the UCP. After the containers were opened it was found that 80% in the cargo was soil, and not scrap. The lawyers of the buyer are aware that there is no valid claim against the carrier, or against the bank. The only chance is to sue the seller, which seems to be without significant assets, so even if successful, the award may not be enforceable. This kind of trouble was ultimately caused by a defect in the UCP, and not only by failure to engage a surveyor. After all, many companies may not employ the surveyor’s services to verify condition of the scrap cargo.

The UCP should be drafted in the way to protect the customers, and many of its provisions on transport documents serve that purpose. Revisions of the UCP suggested by this text would not be difficult and would not cause problems in implementation. Harmonizing the rules on letter of credit with rules applying to contract of carriage, where possible, would reduce legal uncertainty and problems that arise in practice. This would also help the letters of credit to maintain its position as a leading instrument of payment in international trade in the face of challenges by other forms of financing.

Under the assumption that at least some arguments in this paper are correct, the drafters of the next revision of the UCP should take care to correct shortcomings in its present text and make efforts to harmonize letter of credit rules on clean bills of lading with corresponding rules that apply in carriage of goods.

Another recommendation would be that all provisions related to clean bills of lading should be placed in one article rather than being scattered in different provisions. This would contribute to greater clarity and would reduce unnecessary confusions.

The UCP has proven to be a great success, achieving greater uniformity than any other international instrument has ever been able to achieve in the area of transnational commercial law. Of course, the credit for this success goes to its drafters. But nothing is so good that it cannot be improved further. It is hoped that ideas expressed in this paper may contribute to a still better UCP.⁴⁴

⁴⁴ I have shared this text and my views in informal contact with the ICC Banking Commission and the reaction was receptive and positive. I hope that some of the ideas from this text may eventually be incorporated in the next revision of the UCP.